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EXCEPTION

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IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA	Docket No. E-01933A-07-0402
IN THE MATTER OF THE FILING BY TUCSON ELECTRIC POWER COMPANY TO AMEND DECISION NO. 62103.	Docket No. E-01933A-05-0650

Arizona Corporation Commission
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EXCEPTIONS OF THE RESIDENTIAL UTILITY CONSUMER OFFICE

The Residential Utility Consumer Office ("RUCO") makes the following Exceptions to the Recommended Opinion and Order ("ROO") in Tucson Electric Power's ("TEP" or the "Company") rate application.

INTRODUCTION

The ROO recommends the adoption of the Settlement Agreement ("Settlement"). The Settlement will result in a rate increase of approximately $136.8 million over TEP's adjusted current base rates. ROO at 8. When the actual estimated fuel costs, short term sales, SO2 allowances, and wholesale revenue credits are factored in, the total yearly increase will be approximately $146,248,098 or a 21.5% increase over adjusted current base rates. RUCO-2, Exhibit WAR-1. By most standards, a $146 million increase is a lot of money. It certainly is a lot more than what RUCO and Staff recommended in their direct filings in this case - $36 million and $9.75 million, respectively.

In order to justify such a large difference and be in the public interest, the Settlement must provide substantial benefits to ratepayers. RUCO has acknowledged that there are benefits to the ratepayers from the Settlement. It has never been RUCO's intention to downplay or dismiss the Settlement's benefits. RUCO's charge has always been, and remains, to look out for the best interests of a particular class of consumers -- residential ratepayers.

RUCO's objection in this case is not that the Settlement does not provide benefits to the ratepayers. RUCO's objection is that from RUCO's analysis, the cost of the Settlement to ratepayers is simply too high.

THE COST OF THE SETTLEMENT IS TOO HIGH

As with any case where a Settlement proposal is being considered, RUCO reviews and analyzes its position, weighs the likelihood of success, and then develops a settlement position. In this case, the issues that account for the large revenue requirement discrepancy described above are for the most part set forth in a chart attached to the Settlement. Settlement Exhibit No. 2. The largest rate base concession that Staff made is the reinstatement of $99 million related to a FAS 143 write-off of accumulated depreciation. RUCO's position on this issue is similar to Staff's, with the exception that RUCO's adjustment is an increase in the accumulated depreciation balance of $112.8 million. The issue is straight forward - utilities historically recognize the cost of asset retirement through annual depreciation accruals.

Prior to FAS Statement No. 143, these retirement costs were placed in TEP's accumulated depreciation account. The effect of these accruals was a reduction to ratebase because the accruals represent the portion of TEP's plant investment that has been paid for by ratepayers and recovered by the Company through depreciation expense. Statement No. 143 requires TEP to write-off a portion of the accumulated depreciation balance that ratepayers have already paid for. This write-off decreases the accumulated depreciation balance, which in turn increases rate base. From a ratemaking perspective, the inequity is obvious, and Statement No. 143 is inappropriate for regulatory accounting where its application will result in the double recovery of the previously accrued asset retirement costs.

The Settlement addresses this issue by providing for a rate case moratorium and for depreciation rates for TEP's generating plant that includes $21.6 million per year for cost removal. ROO at 20, According to the ROO, the Settlement resolves the issue without causing TEP to write-down assets which could detrimentally affect its financial condition. ROO at 39. According to the ROO, the avoidance of write-offs will benefit TEP's capital structure. ROO at 39. Exactly how much ratepayers will be giving up in exchange for the Settlement is unclear, but ratepayers will be paying for assets the Company has already recovered. RUCO believes that its litigation position on this issue is well grounded and likely to point to ways in which the Commissioners can amend this Settlement to yield a more equitable result.

Another of the many concessions that Staff made in exchange for the Settlement includes $41.6 million which also relates to TEP's Accumulated Depreciation balance. Settlement Exhibit No. 2. The explanation for this adjustment is simple – since 2004 the Company began depreciating its generation assets at rates that were substantially lower than what the Commission authorized in its last rate case. The adjustment trues-up the accumulated depreciation balance to the Commission's authorized rates from TEP's last rate case. RUCO believes that its litigation position on this issue is also well grounded and likely to result in a favorable decision if litigated.

The list of concessions is long and the point here is not to itemize them, estimate the likelihood of success if litigated, or to be critical of Staff or any other party for making the concessions. Nor is the point to be critical of the ROO. As Staff pointed out, in reaching a Settlement in a case this complex, parties have to carefully consider their litigation positions and work towards reasonable compromises whenever possible. However, RUCO believes that after the litigation risks and all other things are considered, if there comes a point when the concessions significantly outweigh the exchanged benefits, then the Settlement is not in the best interests of ratepayers. In this case, the approximate $110 million a year additional that it will cost ratepayers beyond what RUCO is recommending in its direct case outweighs the benefits the Settlement offers.

RESOLUTION OF THE FIXED COMPETITION TRANSITION CHARGE ("FIXED CTC") IS NOT AN ADDITIONAL BENEFIT TO RATEPAYERS

One of the two issues of substance that the Settlement did not resolve was the determination of the fixed CTC.[1] Under the terms of the 1999 Settlement Agreement, the fixed CTC was set to terminate December 31, 2008 or when the Company recovered $450 million of its stranded costs, whichever is earlier. Decision No, 62103 at 5. The Company had recovered $450 million by May 2008. However, the Commission, in Decision No. 69568 continued the fixed CTC charge until the Commission ordered otherwise. Decision No. 69568 at 21. The Commission felt that it was necessary to continue the fixed CTC because of the uncertainty of the impact of the then forthcoming rate case and to avoid the potential confusion that may have resulted if rates declined for six months and then increased. Decision No.

[1] The other issue has to do with when rates will go in effect. The ROO provides that rates will go into effect the first of the month following Commission approval. ROO at 41.

69568 at 16. The Commissions' Utilities Staff ("Staff") estimated the amount of the fixed CTC revenues ("the fixed CTC true-up revenues") for the period of May 2008 through December 2008 would total $67.9 million.

Both Staff and RUCO advocated that the fixed CTC true-up revenues should be returned to ratepayers. Transcript at 1075, ROO at 33. TEP argued that the fixed CTC true-up revenues should continue and that any refund or credit for the fixed CTC revenues would be inequitable and confiscatory. ROO at 34. The ROO recommends that the fixed CTC true-up revenues should be credited in their entirety to the ratepayers by means of a credit to the PPFAC. RUCO supports this aspect of the ROO but notes that crediting the revenues to the ratepayers is not an additional benefit to ratepayers or a counterbalance to the inequities of the Settlement. The ratepayers are getting no more than what they had coming under the terms of the 1999 Settlement Agreement which TEP signed and the Commission approved. With all due respect to the Commission, requiring ratepayers to pay more than they should because of concern that the ratepayers may be confused by disruptions in their rates is bad public policy and not respectful to ratepayers. Ratepayers should never overpay for electric service for the sake of administrative expediency.

The ROO does not provide any further guidance on how the fixed CTC true-up revenues will be credited. RUCO recommends that the method the Commission adopts returns the revenues to ratepayers in the same period of time that the Company collected the revenues (i.e. seven months). If the ROO's recommendation does not yield that result (i.e., a rapid return of the money due ratepayers), then the Commission should consider other alternatives.

THE COMMISSION SHOULD CONSIDER OTHER ALTERNATIVES THAT WILL MAKE THE SETTLEMENT MORE EQUITABLE TO RATEPAYERS

RUCO believes that its direct case would provide the best outcome for ratepayers. RUCO understands that reasonable people can see this Settlement from the perspective that its benefits outweigh its costs and that the Settlement is in the public interest. While RUCO may not agree, should the Commission be persuaded, RUCO would offer the following recommendations which would make the Settlement more equitable to ratepayers while still being fair to the other party's interests.

1) Purchased Power and Fuel Adjustment Clause ("PPFAC")

The ROO recommends the approval of a PPFAC. The PPFAC does not provide for a cap or a 90/10 sharing arrangement. RUCO recommends that the Commission adopt an adjustor that would be applicable only to incremental load above the test year level. RUCO's recommendation is similar to the Company's Energy Charge Adjustment Clause ("ECAC") which the Company proposed in Docket No. E-1933A-05-0650.[2] RUCO's recommendation would protect TEP from market price volatility related to load growth; while at the same time will not shift the operational risk of TEP's own generating facilities to ratepayers.

RUCO would also recommend that the Commission require a 90/10 sharing arrangement. The purpose of a 90/10 sharing is to provide the Company with an incentive to control its purchase power and fuel costs. Without this incentive ratepayers will be at unnecessary risk when the costs increase. The Commission, at a minimum should require a 90/10 sharing arrangement.

2) Cost of Capital

The ROO adopts the Settlement which awards TEP a return on common equity of 10.25%. RUCO recommended a cost of equity of 9.44 percent in its direct case. In Staff's

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[2] See Direct Testimony of James Pignatelli, Docket No. E-0133A-05-0650 at 20-21.

direct case, Staff's expert David Parcell testified that the average of the proxy companies he used in his analysis was 10.0 percent[3]. Direct Testimony of David Parcell at 36. The Company should not earn a return on equity above the industry average. In the spirit of compromise, RUCO would recommend the Company be allowed a return on equity of 10.0 percent.

CONCLUSION

The Settlement comes at too high a cost to ratepayers. Nonetheless, the Settlement does provide some benefits to ratepayers. Should the Commission be persuaded the Settlement framework comes reasonably close to being in the public interest, RUCO respectfully requests the Commissioners improve the terms of the Settlement utilizing RUCO's suggestions listed herein.

RESPECTFULLY SUBMITTED this 6th day of November, 2008

Daniel W. Pozefsky
Chief Counsel

AN ORIGINAL AND FIFTEEN COPIES
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of November, 2008 with:

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[3] Although the average of its proxy company's was 10.0 percent, Staff recommended a cost of equity of 10.25 percent because of the additional risk the Company faces due to its lower bond ratings and equity ratios. Direct Testimony of David Parcell at 36.

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